1977 annual report

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OOD
EUMS LTD.

OAKWOOD PETROLEUMS LTD.

Incorporated under the laws of Canada on November 28, 1925

Capital: 7,000,000 shares without nominal or par value, of which 4,772,277 (net) shares are issued and outstanding.

DIRECTORS

DALLAS E. HAWKINS II,
Spokane, Washington, USA.
President of the Company
Chairman of the Board of
American Eagle Petroleums Ltd.

BRIAN S. EKSTROM, *Calgary, Alberta*
Vice-President of the Company
Treasurer of American Eagle
Petroleums Ltd.
President of Brian Ekstrom
Management Ltd.

GERHARD KASDORF, *Calgary, Alberta*
Vice-President of the Company and
President of
American Eagle Petroleums Ltd.

BRIAN G. McCOMBE, *Calgary, Alberta*
Partner, McCombe, Cameron & Cormie

EDWARD G. McMULLAN, *Calgary, Alberta*
President of E. G. McMullan Ltd.

JACK WAHL, *Calgary, Alberta*
Chairman of the Board and
Chief Executive Officer of
Great Basins Petroleum Co.

R. ROSS HAMILTON, *Calgary, Alberta*
President of Great Basins Petroleum Co.
President of Scoteire Exploration Ltd.

OFFICERS

DALLAS E. HAWKINS II, *Spokane, Washington, USA.*
RICHARD D. JENSEN, *Executive Vice-President*
BRIAN S. EKSTROM, *Vice-President, Finance*
KENNETH W. GERMOND, *Vice-President, Exploration*
GERHARD KASDORF, *Vice-President, Production and Operations*
BRIAN G. McCOMBE, *Secretary*
GERTRUDE V. KERR, *Assistant Secretary*

HEAD OFFICE

2700 Shell Centre
400 - 4th Avenue S.W.
Calgary, Alberta T2P 0J4

SUBSIDIARY COMPANIES

Marwood Petroleum Ltd.
Bayview Oil & Gas Ltd.
Flamingo Oils Limited (N.P.L.)
Orient Investments Ltd.
Oakwood Petroleum Corporation
Oakwood Petroleums (U.K.) Limited
Oakwood Petroleums (Ireland) Ltd.
Oakwood Petroleums Italiana S.p.A.
Lochaber Oil Corporation Ltd.
Bueno Oils Ltd.
Coronado Consultants Ltd.
Huron Resources Management Ltd.

American Eagle Petroleums Ltd.
American Eagle Petroleums, Inc.
Gull Oil & Gas Ltd.

SHARES LISTED

The Toronto Stock Exchange

BANKER

The Royal Bank of Canada
Calgary, Alberta

AUDITORS

Thorne Riddell & Co.
Calgary, Alberta

REGISTRAR

Canada Trust Company
Calgary, Alberta

TRANSFER AGENTS

Canada Trust Company, Calgary, Alberta
and Toronto, Ontario

HIGHLIGHTS

our 52nd year of operation

STATISTICS PRODUCTION	**1977**	1976	1975	1974	1973
Oil Production, Barrels	**336,736**	204,345	161,182	173,214	108,493
Daily average, Barrels	**923**	560	442	475	297
Gas Production, MCF	**3,564,276**	1,906,542	1,317,963	1,187,996	1,174,826
Daily average, MCF	**9,765**	5,223	3,611	3,255	3,219
SALES & EARNINGS					
Crude Oil and Natural Gas Sales	**5,434,977**	2,594,838	1,428,553	1,060,939	546,600
Funds provided by Operations	**2,781,958**	1,459,830	484,966	269,948	24,501
Per Share	**60.5¢**	33.5¢	13.3¢	7.4¢	0.7¢
Earnings (Loss) for the year	**992,693**	442,273	(126,596)	(798,172)	(279,359)
Per Share	**22¢**	10¢	(03¢)	(22¢)	(10¢)
LAND HOLDINGS					
Oil & Gas Lease & Permit Acres					
Gross acres	**4,011,305**	1,265,318	1,042,102	846,776	3,467,740
Net acres	**413,643**	221,048	163,053	116,733	286,595
Mining Claims & Exploration					
Gross acres	**9,416**	66,664	65,898	65,898	58,950
Net acres	**787**	6,666	6,451	6,451	5,895
NET RESERVES					
Oil and Condensate, Barrels					
Proven	**2,070,000**	1,640,000	1,016,000	1,072,000	1,160,570
Probable	**1,021,000**	695,000	320,000	621,000	443,700
TOTAL	**3,091,000**	2,335,000	1,336,000	1,693,000	1,604,270
Natural Gas, MMCF — proven and probable	**75,583**	44,596	28,490	24,150	26,044
Indicated Sandhills Gas Reserves, MMCF (net of royalty)	**103,000**	103,000	103,000	103,000	241,034

ANNUAL MEETING OF SHAREHOLDERS

Annual and Special General Meeting of Shareholders of Oakwood Petroleums Ltd. will be held in the Belaire Room at The Calgary Inn in the City of Calgary, Alberta at the hour of 10:00 A.M., Local Time, June 28, 1978. A formal Notice of Meeting of Shareholders together with an instrument of Proxy and Information Circular is being mailed to shareholders together with this report.

PRESIDENT'S REPORT TO SHAREHOLDERS

Oakwood Petroleums Ltd. and Subsidiaries achieved unprecedented growth during the past year and new record levels have been set in all segments of the Company's operations. Your Company's gross revenue from oil and gas sales, interest and other sources, showed a 90.6% increase to a new high of $6,448,450. With Oakwood now having 2,030,623 shares or 45.4% of American Eagle Petroleums Ltd., consolidated reports now include this effectively controlled affiliate. While this matter is more fully described in the financial review section, it is noteworthy that, reported profits increased from last year's $422,273 to $992,693, or 229/share. Moreover, a continuously increasing cash flow, to a 1977 level of $2,646,690, should facilitate broader flexibility and financing arrangements, thus enabling Oakwood to aggressively pursue exploration and acquisition objectives both in Canada and abroad.

Supported by these sound financial foundations, the Company is for the first time actively engaged in fully-fledged exploration programs both in Canada and the United States. Although not yet reflected in 1977 reported reserves or financial results, the new emphasis on exploration has already been justified, with significant new reserves added to Oakwood's portfolio. Our East Texas program typifies the merits of these efforts, where two deep gas wells have already successfully been drilled. These new-found reserves with a third most encouraging well now underway, represent a significant beginning both for Oakwood's exploration program and your management's overall objective to enhance the Company's foreign and United States reserves and revenue.

While your Company's emphasis will continue to highlight Western Canada, the uncertainty of the Canadian current gas market clearly demonstrates the wisdom of diversification into non-domestic operations. In addition to our growing exploration thrust in the United States, other investigative work is scheduled for recently acquired offshore interests in Australia, and the Seychelles Islands off the east coast of Africa. These offshore frontier areas require considerable geological reconnaissance work before direct exploration methods and drilling can be applied. However, your management has hope that these early preliminary efforts will reveal significant hydrocarbon potential, thus stimulating sufficient industry interest to ensure an on-going position for Oakwood.

DALLAS E. HAWKINS II,
President

Your management is presently negotiating the sale of Oakwood's interest in Block 3/7 in the British North Sea. While the terms being offered by the buyer appear most favourable and would if consumated net your Company's treasury approximately $1,000,000, ultimate acceptance of this offer should not be regarded as a change of direction with respect to the custody of corporate assets. On the contrary, we are in general buyers rather than sellers, and fully anticipate continued growth through a highly aggressive but selective acquisition policy. The Consumers' Gas purchase, more fully detailed in our exploration and operations reviews, having both producing reserves and highly potential exploration lands, exemplifies this policy. This purchase, and other more recent transactions completed on properties in Helmet, British Columbia, and Edwards County, Kansas, have and will continue to add important new reserves to the fibre of Oakwood.

Despite the natural gas over-supply problem now receiving ever increasing attention from industry and government, your management is generally optimistic about the future of Canada's petroleum and natural gas industry. Although we regard it prudent for Oakwood to develop a posture of diversity within the United States and abroad, the Canadian outlook dictates continued energy investment throughout its oil and gas areas. We are, as a consequence, endeavouring to structure an exploratory drilling program. This program, (drilling partnership), will, when consumated, offer Canadians a vehicle through which direct investments in the petroleum industry can be made. Moreover, for reasons of the program's capacity and flexibility, it will accord your Company new and wider exposure to exploration opportunities.

RICHARD D. JENSEN
Executive Vice-President

The program as envisaged by your management team, still requires much hard work and effort before it achieves fruition and becomes operational. It does, however, serve to underline our confidence in the future and a satisfactory resolution to the gas marketing difficulties now being experienced by Oakwood and the industry at large. In this regard, we are most encouraged with the imagination demonstrated by the gas industry, particularly Pan Alberta Gas Ltd., which subject to regulatory consents will be exporting new volumes of gas to the United States in the relatively near future. In this context, a pre-building of the northern border facilities required as part of the delivery system for the Alaska Highway Gas Pipeline Project should, through Pan Alberta's efforts, open new short-term gas markets for up to 800 million cubic feet per day. In our view, this is a quantum achievement and will do much to resolve our current gas over-supply situation and our Nation's growing imbalance in energy accounts.

It should be evident that we are looking forward to continued growth in 1978 and beyond. While our strategy will demand continuous dedication from the entire staff, officers and directors of Oakwood, we know from their past efforts that our confidence in the future is justified.

On behalf of the Board of Directors

Dallas E. Hawkins II

Dallas E. Hawkins II
President

EXPLORATION AND LAND

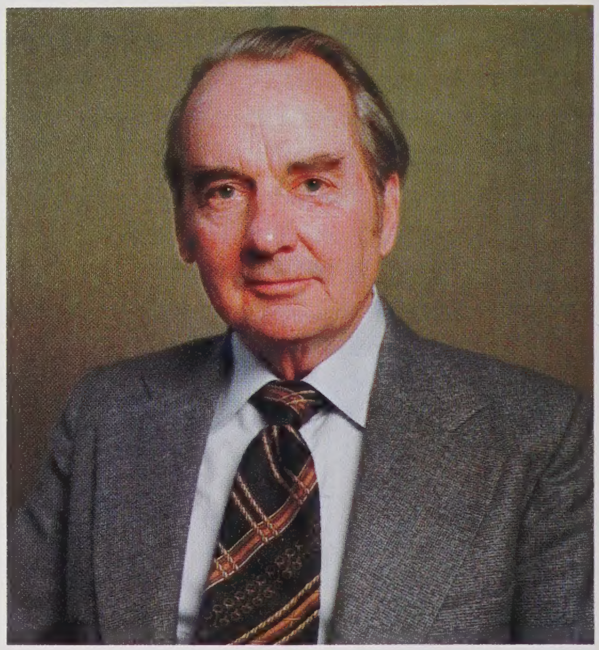
Your Company has historically acquired most of its assets, choosing to buy and develop proven properties rather than participate in the higher risk normally associated with exploration activity. While this corporate philosophy has met with excellent success, it is now clear that new growth can be achieved through a direct exposure to exploration ventures. To implement this plan, a fully staffed exploration department is being created, capable of initiating and assessing undertakings both in Canada and abroad. To this end, Mr. Kenneth W. Germond, a Canadian explorationist with worldwide experience, has been engaged to establish the department and lead your Company in its exploration endeavours.

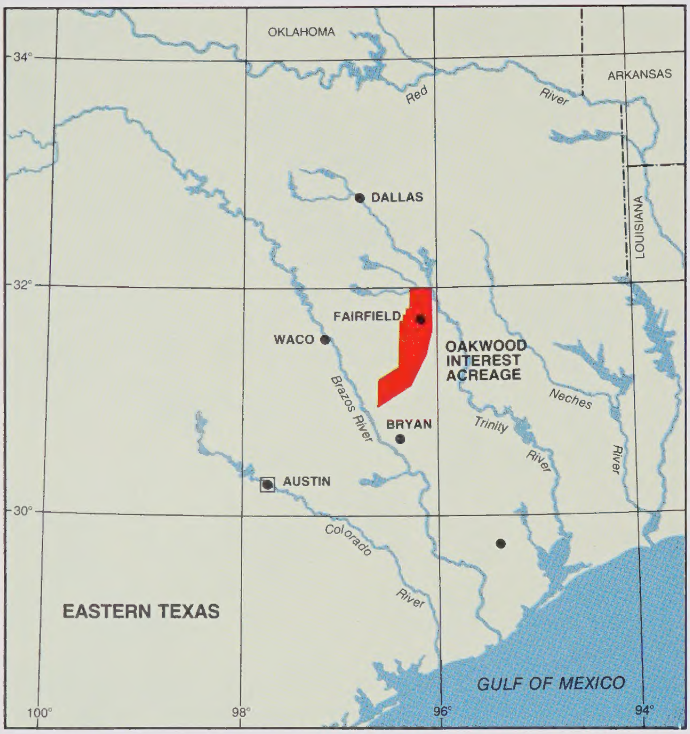
Although your Company proposes broad diversification, it is intended that Canada will continue to be in the exploration forefront. To facilitate these efforts, a Canadian drilling fund employing a limited partnership as its vehicle and Oakwood as general partner, is under serious consideration. Its early consummation will enable evaluation and hopefully ultimate development of twelve exploration prospects, ten in Alberta and two in British Columbia, which have been committed for drilling. Other exploration possibilities are currently being evaluated, and we have every reason to expect that Oakwood will have continuous involvement in the evaluation and drilling of Western Canadian oil and gas prospects. The reserves and producing potential of these and future ventures will be determined through the utilization of two drilling rigs contracted to the Company on a long term basis.

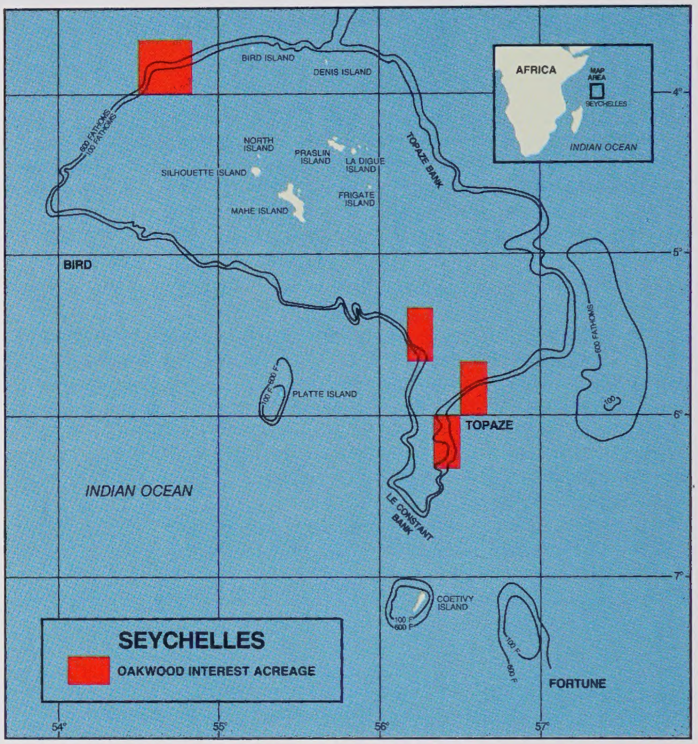
EAST TEXAS JURASSIC TREND

Oakwood Petroleum Corporation has undertaken a 50% working interest position in a multi-pay, low risk, farmin along the deep Jurassic trend in East Texas. Centering in Freestone County, approximately 75 miles north of Bryan and 80 miles south of Dallas, the spread offers the continuing opportunity for the Company and its major company partner to earn half interest in approximately 15,000 net acres of promising lands. To date, the team has finalized two wells and a third is nearing its prime objectives, the deeper of which will be the Jurassic Smackover.

KENNETH W. GERMOND
Vice-President, Exploration







The first one of the two completed wells established gas reserves within the principal objective, the Jurassic Cotton Valley Lime, and log calculations depict additional gas accumulations in the overlying Cotton Valley Sands which includes the Bossier Sand. The second well proved gas reserves in the Bossier Sand, the Cotton Valley Sands as well as the Lime; electric logs show potential zones in the Cretaceous Travis Peak. The third well is drilling deeper in the Jurassic after having successfully proven commercial gas during a drillstem test of a sand within the Travis Peak. Gas purchase contracts are being negotiated and it is anticipated that production will commence within the next few months. In the meantime, other spacing units are being prepared for immediate drilling; the Company will be involved for the next two or three years in the exploration and development of this economically attractive project. Oakwood has granted an option to its associate, American Eagle, whereby it might elect to earn a 25% interest in Oakwood's position by paying for one-third of Oakwood's share of costs during the first phase of the earning period.

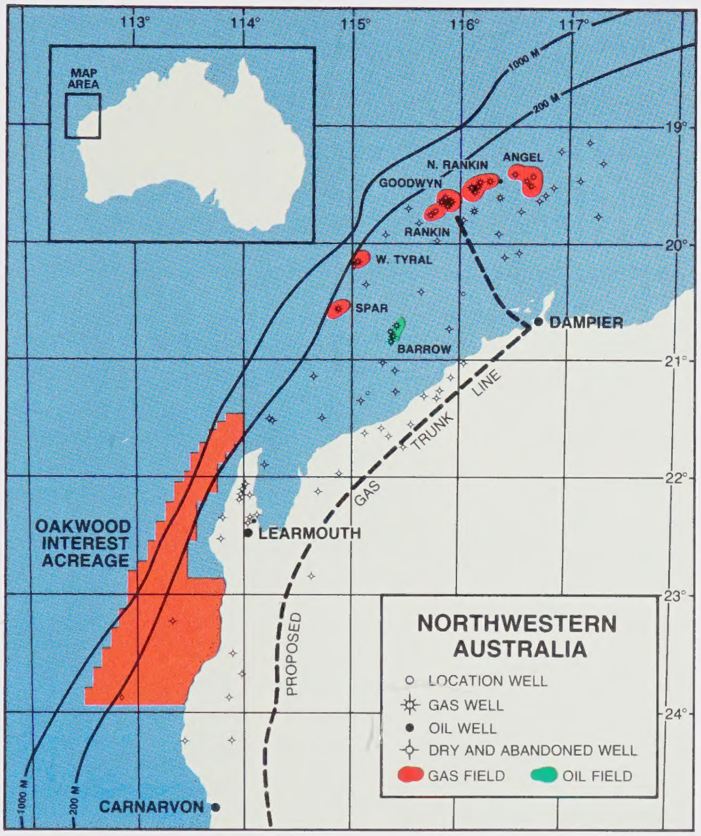
SEYCHELLE ISLANDS

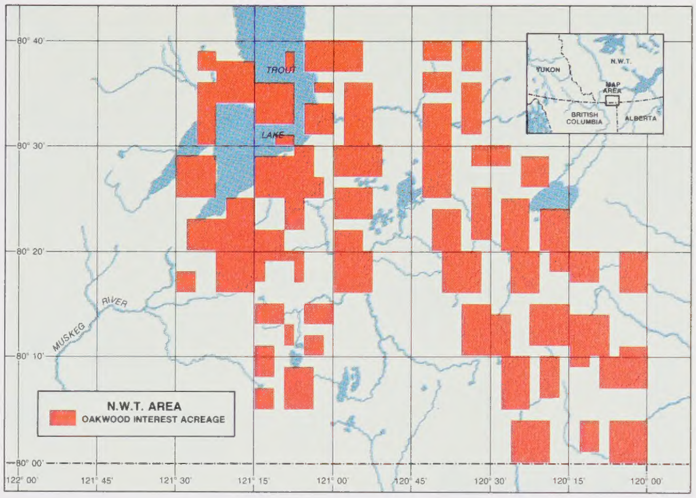
The Seychelle Government awarded five offshore exploration permits totalling 850,000 acres to a group of four companies including Oakwood. The Company has a $12^1/_2$% interest in the prospective blocks and has participated in the acquisition of 400 kilometres of marine geophysical data. Following review of proprietary seismic information shot in January 1978, it is planned to exchange the data for similar information with other permit holders across the Seychelles banks before initiating the next exploration steps.

Located approximately 1400 kilometres east of Africa and in the Indian Ocean, the Seychelle Islands and banks are considered to be a micro-continent, a remnant left behind when India separated from Africa, Australia and Antartica during the Cretaceous Era. Within the confines of the island-ring, waters are relatively shallow, overlying thick prospective sedimentary beds considered to be of Mesozoic to Tertiary age.

AUSTRALIA

Another foreign venture opportunity led the Company to Northwestern Australia where Oakwood with two other Canadian exploration companies teamed with an Australian partner in acquiring an 18,400 square kilometre (4,546,000 acres) offshore petroleum exploration permit. Located within the Carnavon geological basin, the lands are prospective within the





Cretaceous, Jurassic, and Paleozoic rocks, all of which have evidenced petroleum showings in wells drilled elsewhere within the basin.

Oakwood, with its 15% working interest in the project has together with the other parties committed to expend approximately $500,000 (Australian) during the first two year period of the Permit life. Such an expenditure will provide 1200 km of reconnaissance seismic plus 400 km of detail, infill seismic control. Should drilling be justified, such would be commenced in the subsequent or third year when it would be necessary to spend at least $4,500,000 in order to extend the Permit life.

NORTHWEST TERRITORIES

Furthering the expansion of the Company's exploration program in Canada led to the purchase of a 33 1/3% working interest in a large acreage play in the Island River - Trout Lake area of the Northwest Territories. A formal purchase agreement has been finalized whereby Oakwood and another Canadian exploration oriented company each acquired a one-third interest in partially explored leases totalling 440,328 gross acres.

The lands are located immediately north of the northern boundary of Northeast British Columbia where petroleum exploration has been underway for many years, proving large reserves of gas and oil in Devonian carbonate rocks. Early exploration on the newly acquired lands has found excellent showings of oil and gas in rocks of the same age. When the available well information and existing seismic data relative to the acreage have been assimilated, future exploration plans will be formulated between the partners.

CONSUMERS' GAS PROPERTIES

In early 1978, Oakwood purchased from Consumers' Gas Company of Toronto, Ontario, its producing and non-producing properties located in Saskatchewan, Alberta and British Columbia. The negotiated cost totalled $20.1 million. In order to finance the purchase of the asset, Oakwood subsequently sold to an active exploration company a 90% net profits interest in all of the acquired properties for approximately $18 million.

The acquisition was important for the Company. In addition to the cash-flow generated by oil and gas sales, the Company's acreage inventory in Alberta and British Columbia was greatly enhanced. Consumers' had acquired over the years varied working interest lease positions under approximately 400,000 gross acres of prospective lands, and it is this spread of leases that immediately strengthens Oakwood's exploration opportunities in Western Canada. Continuing studies are underway to assimilate as soon as possible the acreage, with its existing and potential prospects, into the Company's plans for further exploration.

LAND ACTIVITIES

The decision to more aggressively engage in exploration activities has provided leasing opportunities in several promising areas around the world as well as within the confines of the Alberta Basin. Meaningful positions were acquired during the last half of 1977 in Alberta, East Texas, and in the Seychelle Islands. A summary of the Company's land holdings as of January 1, 1978 are given in the following table.

Oakwood, American Eagle & Subsidiaries
Oil and Gas Rights Held, January 1, 1978

	Gross	Net
Western Canada		
Alberta	969,596	122,939
Saskatchewan	297,086	73,866
Manitoba	480	60
British Columbia	71,109	2,075
Northern Canada		
Arctic Islands	160,031	*
Northwest Territories	116,600	720
Eastern Canada		
Offshore Labrador	866,118	86,150
Flemish Cap	430,284	*
United States		
Montana	91,722	11,513
North Dakota	6,922	5,147
Ohio	876	674
Texas	9,773	959
Kentucky	15,130	*
California	1,724	741
Foreign		
United Kingdom North Sea	25,012	438
German North Sea	98,842	2,111
Seychelle Islands	850,000	106,250
	4,011,305	413,643

*Overriding Royalty Interest Only.

Negotiations for significant acquisitions were commenced in 1977 but not finalized until 1978 in the Northwest Territories of Canada, offshore Western Australia, and an expansion of the East Texas Jurassic lease play. The figures accompanying these plays have not been included with the 1977 totals.

PRODUCTION AND OPERATIONS

During 1977 your company enhanced both its reserve base and production rates through a selective program of property acquisition and development drilling. We participated in 67 drilling ventures which resulted in 30 oil wells, 25 gas wells and 12 dry holes. Although excellent results were obtained in the oil development program, largely involving the Vermilion play, the current gas over-supply situation and the strict enforcement by gas purchasers of contractual agreements caused Oakwood to focus much of its efforts on the maintenance of deliverability as called for under various gas sales contracts. Development wells were drilled in both the Matziwin and Saddle Lake areas for this purpose. These efforts increased the number of Oakwood interest producing wells in Matziwin from 46 to 49. Similarly, drilling in the Saddle Lake area added two producing gas wells to the Oakwood properties which now have 16 producers.

In keeping with our overall corporate objectives three significant acquisitions were concluded in the year under review. These purchases including both producing properties and undeveloped lands were with one exception, (Dimmit County, Texas) made late in 1977. As a consequence these new assets made only a modest contribution to your company's 1977 production averages. It is gratifying to note however, that effective drilling and previous acquisition efforts increased "net after royalty", crude oil and natural gas production to new highs of 923 barrels per day and 9.765 million cubic feet per day. It is anticipated that 1978 will feature further growth in both oil and natural gas production levels since the following acquisitions have added to the company's producing assets:

1. Dimmit County, Texas

This property mentioned in our 1976 Annual Report was effectively acquired January 1, 1977 by your company's U.S. subsidiary, Oakwood Petroleum Corporation. Marketing problems resulted in a two month shut-in and as a result all six wells on the property have not fulfilled original expectations. Fortunately however, these problems appear to have been resolved, and 1978 production should show an improvement over the 0.4 million cubic feet of gas per day attributed to Oakwood's interest during 1977. Indicated additional reserves underlying the 8,000 gross acres included in the original purchase justify our confidence for future development, and further drilling is now in the planning stages.

2. Jenner, Alberta

During 1977 your company purchased a 43.75% interest in 10,880 acres containing 49 producing wells. The property, near Jenner, Alberta produces gas from the second White Specks, Medicine Hat and Milk River zones. While the asset was purchased for 3.01 million dollars, subsequent completion expenditures vaulted the overall cost to in excess of 3.6 million dollars. This amount was financed through a resale to various investors who acquired 80% of Oakwood's interest until payout. At payout the investors' participation reduces to 50%. In summary, Oakwood has a net interest in the amount of 8.75% until payout increasing to 21.875% after payout.

Oakwood and partners have negotiated a new gas purchase contract covering this property resulting in average net sales of 6.08 million cubic feet of gas per day.

3. Helmet, British Columbia

Effective November 23, 1977 Oakwood acquired all of the producing interest in the Helmet Field Area of Northeastern British Columbia, previously owned by Helmet Petroleum Corporation of Denver, Colorado. The property is comprised of working interests ranging from

GERHARD KASDORF
Vice-President, Production and Operations

10 to 50% covering Crown Petroleum and Natural Gas Rights aggregating approximately 10,000 gross acres. At present there are four Devonian gas wells from which production is being sold under a contract to the British Columbia Petroleum Corporation. This asset combined with the interests more recently acquired from Consumer's Gas Company provides Oakwood with a substantial presence in Northern British Columbia. It is intended that further development will enhance the reserves already delineated.

4. Consumers' Gas Company Purchase

Effective January 1, 1978 Oakwood Petroleums Ltd. purchased for 20.1 million dollars certain producing and non-producing properties from the Consumers' Gas Company of Toronto. Oakwood subsequently sold a 90% profits interest in these properties to Sundance Oil Canada Ltd. for $18,090,000. The acquisition included various interests in gas and oil properties located in British Columbia and Alberta, with the major asset values coming from the Big Bend area of Alberta and Helmet Field of British Columbia.

The Big Bend property is represented by an interest in five producing gas wells and two gas plants. With a prior interest in the area and the 7,138 acres of adjacent undeveloped lands obtained from Consumers', improved production rates may be possible with further development.

The second major developed property obtained in this purchase lies in the Helmet area (Tenaka) of Northeastern British Columbia. This property contains an interest in two shut-in gas wells, and with additional development it is anticipated that these reserves will find a market by 1980.

Consumers' Gas properties also included minor production in the Mitsue, Wainwright, North Myrnam and Sexsmith areas. During 1978 your company will endeavor to further evaluate these holdings and expand production whenever possible.

5. Kansas, Edwards County

In early 1978 Oakwood Petroleum Corporation acquired an interest in seven oil and gas wells in Edwards County, Kansas. Current plans call for the drilling of seven additional wells during the current year, thus adding to both U.S. reserves and production figures.

With the inclusion of the 1977 reserve purchases and our major year-end acquisition (Consumers'), our January 1, 1978 reserve position as evaluated by third party engineers is as follows:

Consolidated Oakwood Net Crude Oil & Natural Gas Reserves

Oakwood Petroleums Ltd. and Subsidiaries	Crude Oil and Liquids		Natural Gas	
Proven Developed	1,688,000		43,104	
Probable Additional	742,000		16,151	
	2,430,000	Bbls	59,255	MMCF
American Eagle Petroleums Ltd.				
Proven Developed	382,000		13,042	
Probable Additional	279,000		3,286	
	661,000		16,328	
Consolidated Total	3,091,000	Bbls	*75,583	MMCF

*Not including 103,000 MMCF Gas Reserves attributed to Sand Hills, Saskatchewan Property.

FINANCIAL REVIEW

The fiscal year ended December 31, 1977 marked a new milestone in the Company's growth and sales records. Sales from crude oil and natural gas production were \$5,434,977, an increase of 110% over 1976 when they were \$2,594,838. This represents the largest single year of growth in the Company's history to date. Cash flow from operations for the year ended December 31, 1977 amounted to \$2,781,958 as compared to \$1,459,830 for the same period in 1976. This represents an increase of 91%. Cash flow per share was almost 61¢ per share in 1977 as compared to 33¢ per share in 1976. Similarly, earnings per share rose to 22¢ in 1977 as compared to 10¢ in 1976.

During 1977, the Company increased its holdings in American Eagle Petroleums Ltd. to approximately 45% of American Eagle's outstanding stock. To date, in excess of two million shares of American Eagle, have been acquired at a cost to the Company of approximately \$3 million. As a consequence of the Company's substantial ownership position, the accompanying financial results reflect full consolidation of the affairs of American Eagle Petroleums Ltd. and its subsidiaries, effective January 1, 1977.

The Company's acquisition and development activities resulted in the expenditure of funds during 1977 of \$7.5 million. These funds plus the funds expended to increase the Company's shareholding position in American Eagle Petroleums Ltd. were funded by way of production bank loans and the Company's cash flow as provided from operations. Further significant property acquisitions were consummated in early 1978.

The Company is now in the final stages of consolidating its debt by the issuance of a \$13 million income debenture to replace its existing production bank loans. At the same time the Company is adding to its equity base by way of a preferred share issue to net the Company approximately \$5,000,000. Additional funds provided by way of the income debenture and the preferred share issue will put the Company in a very solid position to actively pursue both exploration and acquisition policies during the balance of 1978.

As the financial highlights page so clearly indicates, the Company has undergone very rapid growth during the last five years, with sales showing a one hundred-fold increase. Earnings per share have risen from a loss per share in 1973 of 10¢ to net earnings per share of 22¢ in 1977. To handle the increasing level of activities which the Company has been experiencing during this interval, we have been actively building a solid core of administrative and technical staff to administer the Company's operations. In May, 1978, the Company will be moving to its new office quarters on the 27th floor of Shell Centre. This new facility will provide the Company further opportunity for increased growth and activities during the coming year as its operations continue to expand.

BRIAN S. EKSTROM
Vice-President, Finance

AUDITORS' REPORT

To the Shareholders of Oakwood Petroleums Ltd.

We have examined the consolidated balance sheet of Oakwood Petroleums Ltd. as at December 31, 1977 and the consolidated statements of earnings, deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Alberta
April 20, 1978

Thorne Riddell & Co.
Chartered Accountants

CONSOLIDATED BALANCE SHEET

December 31, 1977

ASSETS	1977	1976
CURRENT ASSETS		
Cash	$ 1,240,884	$ 1,191,718
Accounts receivable		
— trade	2,596,491	1,364,128
— sale of resource properties	3,700,000	3,700,000
	7,537,375	6,255,846
INVESTMENT IN AMERICAN EAGLE PETROLEUMS LTD. (note 2)	—	998,244
PROPERTY AND EQUIPMENT		
Producing petroleum and natural gas leases and rights including development and equipment thereon, at cost	27,002,162	14,854,989
Accumulated depletion and depreciation	8,591,733	5,952,218
	18,410,429	8,902,771
Non-producing properties, at cost	3,452,884	1,563,709
	21,863,313	10,466,480
OTHER ASSETS		
Receivables and advances	31,443	10,004
Deferred financing charges	60,577	48,016
Receivable under share purchase plan (note 4)	68,900	133,000
	160,920	191,020
	$29,561,608	$17,911,590

Approved by the Board

Dallas E. Hawkins III Director

Director

LIABILITIES

	1977	1976
CURRENT LIABILITIES		
Bank indebtedness (note 3)	$ 2,936,153	$ 2,955,284
Accounts payable and accrued liabilities	5,345,801	2,934,150
Income taxes payable	133,506	148,873
Current maturities on long-term debt (note 3)	838,293	186,000
	9,253,753	6,224,307
LONG-TERM DEBT (note 3)	11,587,710	5,964,333
DEFERRED INCOME TAXES	2,076,018	1,155,789
MINORITY INTEREST IN CONSOLIDATED COMPANY	743,773	—

SHAREHOLDERS' EQUITY

	1977	1976
CAPITAL STOCK (note 4)		
Authorized		
7,000,000 common shares without par value		
Issued		
5,367,611 shares (1976 — 5,019,785)	10,029,474	9,688,974
CONTRIBUTED SURPLUS	768,152	768,152
	10,797,626	10,457,126
DEFICIT	(4,212,637)	(5,205,330)
	6,584,989	5,251,796
Less 595,334 shares held by wholly-owned subsidiary company	684,635	684,635
	5,900,354	4,567,161
	$29,561,608	$17,911,590

CONSOLIDATED STATEMENT OF EARNINGS

Year Ended December 31, 1977

	1977	1976
REVENUE		
Sale of oil and gas	$5,434,977	$2,594,838
Interest and other	187,233	164,490
Gain on sale of resource properties	826,240	623,703
	6,448,450	3,383,031
EXPENSES		
Field operating	1,477,930	738,259
Non-producing property costs	106,062	87,469
Exploration, engineering and consulting	300,194	171,414
General and administrative	817,914	437,062
Interest on long-term debt	1,099,660	558,829
Depreciation and depletion	1,340,143	483,435
Share of loss of American Eagle Petroleums Ltd. (note 2)	—	142,886
Write-down of other assets	—	92,239
	5,141,903	2,711,593
Earnings before income taxes	1,306,547	671,438
Income taxes		
Current	(198,275)	25,365
Deferred	512,129	223,800
	313,854	249,165
NET EARNINGS	$ 992,693	$ 422,273
NET EARNINGS PER SHARE, based on weighted average number of shares outstanding during the year	$ .22	$ .10

CONSOLIDATED STATEMENT OF DEFICIT

Year Ended December 31, 1977

	1977	1976
DEFICIT AT BEGINNING OF YEAR	$(5,205,330)	$(5,627,603)
Net earnings	992,693	422,273
DEFICIT AT END OF YEAR	$(4,212,637)	$(5,205,330)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year Ended December 31, 1977

	1977	1976
WORKING CAPITAL DERIVED FROM		
Operations	$ 2,781,958	$1,459,830
Long-term debt		
Production bank loans	3,900,829	696,700
Other	1,819,228	1,284,260
Issue of capital stock		
On acquisition of subsidiary	—	1,582,404
On conversion of 9% debentures	400,000	—
Other	84,120	1,000
	8,986,135	5,024,194
WORKING CAPITAL APPLIED TO		
Acquisitions (note 2)	984,338	5,236,238
Less working capital (deficiency) acquired	(686,001)	2,633,516
	1,670,339	2,602,722
Additions to property and equipment	7,547,316	2,208,390
Purchase of shares of American Eagle Petroleums Ltd.	—	47,680
Current maturities on long-term debt	635,398	110,000
Repayment of long-term debt	788,468	50,000
Other	92,531	—
	10,734,052	5,018,792
INCREASE (DECREASE) IN WORKING CAPITAL	(1,747,917)	5,402
WORKING CAPITAL AT BEGINNING OF YEAR	31,539	26,137
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	$(1,716,378)	$ 31,539

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended December 31, 1977

1. ACCOUNTING POLICIES

(a) Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned, and American Eagle Petroleums Ltd. which was 45.4% owned at December 31, 1977 (see note 2).

The excess of the consideration paid for shares of consolidated companies over the net book value of the assets acquired has been included in property and equipment in the consolidated balance sheet and is being amortized on the same basis as such assets, or has been deducted from shareholders' equity to the extent of the carrying value of the Company's shares held by the purchased company.

(b) Property and Equipment

The Company follows the practice of capitalizing the acquisition costs of both producing and non-producing properties and charging the costs to earnings if the property is subsequently surrendered. The cost of drilling a productive well is capitalized; and, the cost of a non-productive well is charged to earnings when the well is determined to be dry except for such costs incurred to evaluate areas for lease selection in the United Kingdom North Sea which costs are capitalized. The costs of producing leases and development thereon are amortized using the unit of production method based upon estimated quantities of oil and gas as determined by the Company's engineers.

Equipment is depreciated on a diminishing balance basis over its estimated useful life at annual rates varying from 10 to 20 percent.

(c) Income Taxes

The Company follows the tax allocation method of accounting under which the income tax provision is based on earnings reported in the financial statements. Accordingly, the Company makes full provision for income taxes deferred as a result of claiming capital cost allowances and exploration and development costs in excess of the amounts provided for depreciation and depletion in the financial statements.

(d) Foreign Currencies

The accounts of foreign subsidiaries have been translated into Canadian dollars on the following basis:

(i) current assets and liabilities at the rate of exchange at December 31, 1977;

(ii) all other assets, applicable depreciation and depletion and non-current liabilities at rates prevailing when the assets were acquired or the liabilities incurred;

(iii) revenue and expenses, except depreciation and depletion, at the average rate in effect during the year.

Gain or losses resulting from such translation practices are capitalized as part of property and equipment and subject to the same amortization policies (see note 1(b)).

2. AMERICAN EAGLE PETROLEUMS LTD.

The Company has been acquiring shares of American Eagle Petroleums Ltd. (American Eagle) since 1973. In 1974, the Company owned approximately 28% of American Eagle and commenced following the equity method of accounting for this investment. The Company's ownership of American Eagle was increased from 31% to 45% during 1977. Effective January 1, 1977 the Company has consolidated the accounts of American Eagle because management considers this to be the more informative presentation.

This business combination has been accounted for utilizing the purchase method. The net assets and values assigned thereto are as follows:

Property and equipment		
Book value		$ 3,237,747
Increase to fair value		1,195,501
		4,433,248
Working capital deficiency	$ 686,001	
Other liabilities	1,713,844	(2,399,845)
		2,033,403
Minority interest		(575,471)
Cash cost of acquisition expended prior to 1977		$ 1,457,932

The excess of costs of the acquisitions over the book value of the net assets acquired is approximately $2,000,000 (including $1,195,501 as at January 1, 1977 — see above). This excess has been attributed to property and equipment and is subject to the accounting policies outlined in note 1(a).

3. LONG-TERM DEBT

	1977	1976
Oakwood Petroleums Ltd. and subsidiaries		
Production bank loans	**$ 8,321,033**	$4,640,204
Prepayments under gas sales contracts	**291,661**	360,129
Fixed charge debenture	**430,000**	550,000
9% convertible debenture	**—**	600,000
Notes payable	**819,228**	—
	9,861,922	6,150,333
Less current maturities included in current liabilities	**706,960**	186,000
	9,154,962	5,964,333
American Eagle Petroleums Ltd. and subsidiaries		
Production bank loans	**1,400,000**	—
Prepayments under gas sales contracts	**164,081**	—
Subordinated debenture	**1,000,000**	—
	2,564,081	—
Less current maturities included in current liabilities	**131,333**	—
	2,432,748	—
	$11,587,710	$5,964,333

(a) Oakwood Petroleums Ltd. and subsidiaries

The bank indebtedness included in current liabilities and production bank loans as evidenced by demand promissory notes are secured by petroleum and natural gas properties, accounts receivable and shares of American Eagle Petroleums Ltd.

The production loans are repayable out of future production proceeds and, accordingly, are not expected to require the use of working capital; therefore no portion of these loans has been reclassified to current liabilities. Interest is payable at the rate of 1% above the prime rate set from time to time by a Canadian chartered bank ("bank prime rate").

The fixed charge debenture is secured by a specific second charge against the assets of the Company in the Saddle Lake area, and a floating charge against the assets of the Company in Alberta and Saskatchewan. It is

repayable in monthly installments of $10,000 until June 1981, plus interest at bank prime rate plus 1%. In addition, the lender is to receive a fixed royalty from the Saddle Lake properties to earn until June 25, 1986 an aggregate of $165,000.

(b) American Eagle Petroleums Ltd. and subsidiaries

The production bank loans are evidenced by demand promissory notes and are secured by specified petroleum and natural gas properties and a first floating charge debenture on all other assets of American Eagle.

The production loans are repayable out of future production proceeds and, accordingly, are not expected to require the use of working capital; therefore, no portion of such loans has been reclassified to current liabilities. Interest is payable at the rate of $1^1/_2$% above the bank prime rate.

The subordinated debenture is secured by a second floating charge on all assets of American Eagle. The debenture is repayable over five years by monthly installments commencing August 1978. Interest is payable at the bank prime rate plus 1% (minimum 9% — maximum 12% per year). In addition the debenture holder is to receive a fixed royalty from certain gas properties of $2,500 per month from September 1977 to August 1983, and $1,250 per month from September 1983 to August 1987. Financing charges of $46,346 related to the issuance of the debenture have been deferred and are being amortized on a straight-line basis over the term of the debenture.

(c) Principal Payments for Next Five Years

The estimated principal payments on long-term debt for the next five years are as follows: 1978 — $2,031,000; 1979 — $2,464,000; 1980 — $2,740,000; 1981 — $2,304,000; 1982 — $1,694,000.

4. CAPITAL STOCK

Changes in the Company's capital stock during the year ended December 31, 1977 were as follows:

	Number of Shares	Carrying Value
Balance at December 31, 1976	5,019,785	$ 9,688,974
On conversion of 9% convertible subordinated debentures	347,826	400,000
Reduction in purchase price of shares issued to officers of Company	—	(59,500)
Balance December 31, 1977	5,367,611	$10,029,474

During 1974, 70,000 shares were issued to three officers of the Company under the terms of a share purchase plan. During 1977 the shareholders of the Company approved the reduction in the purchase price from $1.90 to $1.05 per share. The amended aggregate consideration of $73,500 was paid prior to March 21, 1978, the expiry date of the plan.

At December 31, 1977, 60,000 common shares were reserved for issuance at $3.83 each under an employee incentive stock option plan.

Subsequent to December 31, 1977, an officer of the Company was granted an option to purchase 100,000 shares at $4.17 each during the three year period ending March 14, 1981.

5. SUBSEQUENT EVENT

Subsequent to December 31, 1977, the Company entered into an agreement to purchase certain petroleum and natural gas properties for cash consideration of $2,040,000.

6. COMMITMENTS

During 1978, the Company must expend a minimum of $2,345,000 to retain its interest in certain property and equipment reflected in the consolidated balance sheet as at December 31, 1977 at $900,000.

7. STATUTORY INFORMATION

During 1977 the consolidated group of companies paid $4,900 to the Company's seven directors in their capacity as directors and paid $198,660 to six officers of the Company, three of whom are also directors.

1977 annual report

OAKWOOD PETROLEUMS LTD.